

California Bankers Association

State and Federal Legislative Developments

Gregory O. Wilhelm
SVP/Director of Government Relations
Maurine C. Padden
VP/Chief Legislative Counsel

State Report

Political Context. Although the Legislature has adjourned its regular session for 2001 (a third energy-related special session is may be called by the Governor to begin in early October to deal with the energy company bailout), hundreds of bills are awaiting action by Governor Davis on or before October 14th. For CBA and other financial services organizations, this legislative year has been a struggle. Democratic hegemony over both houses of the Legislature, as well as the Governor's office, has made the state GOP nearly an afterthought. The *status quo*, bipartisan reapportionment plans approved by the Legislature were the best that Republicans could hope for in this environment: a 50-30 deficit in the State Assembly and a 26-14 gap in the State Senate. Moreover, the state budget was approved largely as the Governor wanted it after goodies were promised and delivered to enough minority caucus members needed to secure the 2/3-vote requirement.

The legislative environment has changed considerably for the banking industry. The Assembly Banking Committee, once a place where ill-conceived or poorly written bills could be stopped, has proven to be a much more hospitable place for bills opposed by CBA. The Senate counterpart is willing and able to address our concerns, but the Senate Banking Committee is by no means a reliable venue for bankers' views to be heeded. In the executive branch, Governor Davis, is running for re-election next year and is under some pressure to deliver to key Democratic constituencies—labor, trial lawyers, consumer groups—to shore up his left flank. Business groups continue their ongoing dialogues with the Governor to remind Mr. Davis that his jealously guarded moderate reputation could be severely damaged by opening the floodgates to a host of liberal legislation. Although it is too early to close the book on the 2001-2002 session, at best, CBA can hope for a mixed bag on many of the issues ~~it~~ that we have been advocating for—and against.

2001 CBA Sponsored Legislation. CBA's sponsored bills have fared well so far this legislative session:

SB 364 (Alpert) – Our recently-enacted statute secures parity with real estate mortgage licensees to assess one day's interest on funds awaiting disbursement from escrow. It has been signed by the Governor and becomes effective January 1, 2001. (Chapter 302, Statutes of 2001).

SB 415 (Dunn) – This measure clarifies a bill enacted last year (SB 1724) on the privacy of tax return information for joint accounts. The road to enactment of SB 415 has been somewhat rocky because the measure includes a provision to make it easier for taxpayers to file online tax returns. Private sector tax filers—including Intuit (which owns TurboTax) -- oppose this last provision and as a result, the measure was placed on the "suspense" file of the Assembly Appropriations Committee without further action. SB 415 has been held over until January 2002. In light of the opposition to the online filing provisions, CBA may seek another vehicle for the technical clean up to existing law that we need.

Subchapter S conformity with Federal Law – Although CBA was optimistic in January that we might have changes to Subchapter S rules at the federal level, such changes have not been forthcoming. Several such bills were introduced in Congress this summer, so it is possible that a California conformity effort will be pursued next year if and when the Congressional agenda returns to issues that are not tied to the current crisis on terrorism.

The Major Issues. The big battles waged in the Legislature this year include the following issues:

Financial privacy. This issue has been the most difficult challenge facing the financial services industry this year. Following the passage of the federal Gramm-Leach-Bliley Act (GLBA), it was the hope of many that efforts at resisting changes to its privacy provisions in California and other states would be successful. The July 1, 2001 effective date for GLBA privacy notices to consumers has passed and the verdict among many in the public—and the legislators who represent them—is that many banks, other financial service providers and credit grantors did a poor job of clearly notifying customers of their new privacy rights, including simple instructions and formats for exercising opt-out rights. In addition, since GLBA expressly provides an invitation to states to enact stricter privacy rules, a protracted war is underway in California between the self-proclaimed consumer interests and the financial services sector over privacy protection.

One other factor has emerged that cannot be discounted and was not foreseen several months ago. The media, particularly the *San Francisco Chronicle*, has taken up the privacy issue as a crusade the likes of which have not been witnessed in Sacramento for decades, if ever. Front pages news stories, editorials, calls-to-action, pictures of legislators opposing the Chronicle's position, are just a few of the tactics used in this battle. And the legislators are listening. That is why, despite the defeat of an opt-in privacy notice bill in the Assembly Banking Committee earlier this year (AB 203—Jackson) and the apparent defeat of another (SB 773—Speier), the Speier bill remained active until the second to last day of the legislative session because 18 moderate Democratic Assemblymembers refused to vote for the bill when it was taken up at 1 a.m.

Although the Assembly did not pass SB 773 this year, the bill is still alive on the Assembly Floor and can be taken up at any time before the Legislature adjourns August 31, 2002. The author, the sponsors and the *San Francisco Chronicle* will be working hard to find nine more votes. It will be incumbent upon bankers, and other members of the financial services industry, to use the next three months to do a much better job explaining to consumers what their privacy rights are if they expect to blunt the need for SB 773 or similar legislation. The fact that the Governor issued his own privacy proposal increases the likelihood that some legislative action will occur next year. Of course, in light of the terrorist attacks in New York and Washington, D.C., it remains to be seen whether the collective will for additional privacy protections will be present.

Telemarketing/Do Not Call List. SB 771 (Figueroa), which creates a statewide do-not-call telemarketing list, gained considerable traction in the last couple of weeks of session after the President Pro Tem of the Senate received numerous telemarketing calls on his cell phone. CBA worked with the author to secure amendments to address our operational concerns such as an exclusion for existing business relationships (which includes affiliates that share a brand name) and a compliance safe harbor. The Governor joined the chorus of voices in support and is expected to sign this measure now that it is on his desk.

Predatory Lending. Predatory lending is a close second to privacy in its import to the financial services industry this year. The current vehicles, AB 489 (Migden)/AB 344 (Migden), are extremely complex measures that try to be all things to all people and fail miserably. The predatory lending legislation Ms. Migden has authored sweeps too broadly and likely would severely impact sub-prime lending and the availability of credit to a population that might not otherwise be served by our institutions. Although the Governor is expected to sign the predatory lending legislation now before him, it was substantially modified to provide a more reasonable limit on the interest rate spread (8%) and allowable points (6) to avoid the dreaded “predatory” label. Moreover, express exclusions for open end lines of credit, loans secured by second homes, reverse mortgages and bridge loans with a maturity of one year or less removed many concerns. The measure is silent on preemption of local ordinances, which was a CBA priority, but passage of the law will nonetheless give some credence to arguments in court (if local governments are sued) that the state has now occupied the field. Bank of America recently pulled out of the sub-prime market, in part due to the difficulty of making a profit in this product line but also due to the plethora of local and state legislation on this subject. Compliance with these laws, if enacted, will be a nightmare and

a slew of class action litigation may be expected. There are some who believe that federal preemption arguments may win in court, but there is no guarantee this view will prevail. The fallout from this measure, should the Governor approve it as expected, will take not months, but years.

Credit Unions. Coming after the enactment of membership reform legislation at the Federal level three years ago, the California Credit Union League (CCUL) announced last Fall it had two major legislative goals: First, to obtain a broad expansion of powers for its state-chartered members and second, to enact specific authorization for credit unions to provide trust services to their members from within the non-profit institution.

CCUL achieved some initial success with their sponsored bill, AB 684 (Kehoe), which was approved by the Assembly on a 51-6 vote. However, CBA's opposition based upon questions about safety and soundness, unfair competitive advantage, lack of expertise on the part of many credit union managers and the potential for a repeat the 1980's S & L crisis were better received by the Senate Banking Committee where the measure stalled. AB 684 was turned into a two-year bill by its author, Christine Kehoe, Assistant Speaker Pro Tempore. Based on research conducted by CBA, *if their current rate of growth is maintained, state-chartered credit unions will have more deposits than state-chartered banks by 2008!* Over twenty charter conversions—from federal to California—are pending at the State Department of Financial Institutions. The evidence is clear: the credit union competitive threat is real and serious. Many legislators use credit unions as their primary financial institution and the CCUL has been very politically active. Our continued success on this issue will depend in large part on our ability to force credit unions to justify why they should be able to serve the same customers with the same products as a community bank and not either pay taxes or have CRA responsibilities.

Elder Financial Abuse. This issue is another in the long list of examples of how CBA can turn a potentially troublesome bill into a win-win for the legislator and our members. AB 109 (Alquist) would have, in its original form, required *mandatory* elder financial abuse reporting on the part of bank tellers. As the bill has been amended, it creates a three county pilot project (San Francisco, Santa Clara and Lake counties) to develop training procedures. CBA and a number of member banks have given the author assurances that voluntary reporting of suspected elder financial abuse will be undertaken on a statewide basis. Although the bill stalled in the Senate Appropriations Committee for unrelated technical reasons late in the session, we fully expect this measure to be enacted early in 2002. CBA, working with a number of non-profit organizations specializing in combating elder financial abuse, is taking the lead in developing materials for use in our member institutions. Federal regulators have granted pre-approval for CRA credit for charitable contributions by banks to at least one of the non-profit organizations working toward the goals proposed by AB 109. Training programs authorized under the bill and implemented by members may also count toward a bank's meeting its CRA obligations.

Reconveyances. In a troublesome opinion for mortgage lenders rendered in June of last year, *Bartold v. Glendale Federal Bank*, a court decision was handed down which addressed previously undecided issues regarding trust deed reconveyance practices and the time frames within which a beneficiary is required to "execute and deliver" to the trustee the documents necessary to reconvey the trust deed. The decision requires that the beneficiary must deliver a request for full reconveyance and loan documents "when" a borrower has repaid the loan. Unfortunately, the court defined the "when" to be immediately. Speaker Hertzberg authored AB 1090 that is supported by a broad coalition, including CBA, to overturn the result in the *Bartold* case.

Identity theft. There were three measures that extended new rights to victims of identity theft. SB 125 (Alpert) requires a lender to provide a victim of identity theft with a copy of all application forms used by the identity thief within 10 business days if the person submits to the lender a copy of a police report showing that he or she is a victim of identity theft. The measure also permits the victim of identity theft to authorize the lender to release the information to law enforcement. SB 168 (Bowen) allows a victim of identity theft to close access to his or her credit bureau file. CBA worked with the author to insure that

existing lenders retained the right to access the file and that lenders requesting a file in connection with the underwriting of a loan would be notified if access to requested file had been closed. SB 168 also placed restrictions on the use of social security numbers as account numbers or identification numbers. Finally, AB 655 (Wright) prohibits creditors from selling consumer debt if the debt was the result of identity theft and also requires creditors who use a credit report to verify the consumer's address by telephone or in writing if the address on the credit report does not match the address on the credit application.

Credit Cards. AB 865 (Hertzberg) requires credit card issuers to provide cardholders with a generic disclosure regarding how long it will take the cardholder to payoff a debt if only the minimum payment is made. In addition, the bill requires card issuers to give any cardholder who makes 6 minimum payments in a row individualized information on how long it will take to payoff the balance paying the minimum payment and the toll free number of the National Foundation for Credit Counseling. The provisions of the bill become effective July 1, 2002. Another measure, AB 521 (Koretz) targets the marketing of credit cards to college students (Chapter 294, Statutes of 2001). In addition to defining a "student credit card," the bill mandates the California State University and California Community College systems, and requests the Regents of the University of California, to adopt policies which consider In adopting the policies, the governing bodies are asked to consider the following issues: a) Registration of sites at which credit cards are marketed with the campus administration and consideration be given to limiting the number of sites allowed on a campus; b) Implementation of a prohibition on marketers of credit cards offering gifts to students for filling out credit card applications; and, c) Incorporation of credit card and debt education and counseling sessions into the standard campus orientation of new students.

Taxation. The surplus projected in January disappeared with the economic downturn and California's energy crisis. As a result, state tax relief was small and targeted. Prospects for more relief next year are dimmer still. Nonetheless, one bright spot, supported by CBA, was SB 73 (Dunn). The bill increases the maximum aggregate dollar amount of low-income housing tax credits from \$50 million per calendar year to \$70 million per annum. Beginning in 2002 the bill will also add an annual cost of living adjustment for inflation to the maximum credit level.

Other Issues of Interest:

SB 11 (Escutia)/AB 36 (Steinberg). These measures, sponsored by the trial lawyers, would have relaxed the rules allowing for the confidentiality of legal settlements. In the wake of the Firestone Tire/Ford Motor Co. controversy, there was considerable interest in these proposals and, for a time, it appeared that they might reach the Governor's desk. However, the moderate Democrats in the Assembly held firm and SB 11 did not get off the Assembly floor at the close of session and therefore became a 2-year bill. Expect its return next year. CBA worked with the Civil Justice Association of California, a business interest group comprised of banking, securities, manufacturing and computer sector representatives, to oppose the measure that was amended fairly early in the year to remove any reference to "financial fraud" claims. The coalition continued to oppose the measure as it moved through the Legislature until it was stopped on the Assembly floor. The success of the business coalition was due in part to the alternative reform measure crafted by Silicon Valley Assembly Member Joe Simitian (AB 881). Its appearance on the scene allowed members to focus their attention, and in some cases support, for something other than the trial lawyers' proposals. This strategy is a good template for use in future battles waged by the financial services industry: make sure that members have a "moderate" alternative to those bills opposed by the industry.

AB 1286 (Rod Pacheco). This conservatorship reform bill is currently pending on the Governor's desk. Existing law requires that financial institutions holding assets of a conservatee or ward to file directly with the court specified statements regarding those assets at specified periods during a conservatorship or guardianship. AB 1286 simplifies this disclosure duty: when an account or safe deposit box subject to a guardianship or conservatorship held in a financial institution is opened or changed, the financial institution has an obligation to file an affidavit with the court, signed by an officer of the bank, savings bank, savings

and loan association, industrial bank or credit union where the asset is held. The affidavit must provide the following information if known to the financial institution:

- (1) the name of the person with whom the account or safe deposit box is opened or changed;
- (2) the account number or reference number;
- (3) the date the account or safe deposit box was opened or changed ownership pursuant to the letters of guardianship or conservatorship;
- (4) if the asset is an account, the balance at the time the account was opened or changed;
- (5) if the asset is held in a safe deposit box, a description of the asset including any title, policy number or reference number; and,
- (6) the name and address of the financial institution in which the asset is maintained.

CBA worked with the author's office to ensure that financial institutions were not unduly burdened by unnecessary reporting criteria, an improvement over current law. For example, under AB 1286, all information required by the affidavit is available to the institution in its own records. In addition, CBA secured amendments to existing law to make it clear that financial institutions could meet the statutory duty and obtain immunity provided by the statutory right to financial privacy in current law. The measure provides that the financial institution need not file more than one affidavit per guardianship or conservatorship proceeding and the financial institution may file a single affidavit for multiple assets in multiple accounts and/or safety deposit boxes. The measure becomes effective January 1, 2002.

AB 256 (Wayne). This measure provides that if a resident who is a consumer in this state enters a consumer contract, any action arising from, or connected with, that contract or transaction that is commenced against that consumer shall be filed in this state in one of the following locations:

- (1) the county in which the contract was signed;
- (2) the county in which the consumer resided at the time the contract was entered into; or,
- (3) the county in which the consumer resides at the time the action is filed.

(4) The measure provides that any waiver of this provision is void and unenforceable as contrary to public policy.

The bill takes effect on January 1, 2002.

SB 270 (Speier). This measure provides for additional disclosure to consumers that, if the value of their homes has appreciated, they may be able to cancel private mortgage insurance (PMI). CBA worked successfully to narrow the bill and delay its effective date until July 1, 2002. The Governor signed the bill this summer. (Chapter 137, Statutes of 2001).

SB 281 (O'Connell). To address the issues raised by the holdings in *Kroupa v. Sunrise Ford*, 77 Cal. App. 4th 835 (1999) and to cut off future class action lawsuits against auto dealers, the California Motor Car Dealers Association sponsored this bill to clarify the single document rule applicable to vehicle lease contracts. Specifically, the bill sets forth in greater detail than existing law the types of information which must be included in the lease contract and specifies the documents and agreements not required to be contained in the lease contract. The practical effect is that the bill will require reprinting of existing lease contracts to comply with the change in law. Since the bill applies prospectively with respect to litigation, the effective date is January 1, 2002 (Chapter 287, Statutes of 2001).

Federal Report

Political Context. As we ponder the long-term impact of the barbarous acts of September 11th, it is difficult to pay much attention to the mundane impact on CBA's federal legislative interests. For those CBA bankers and staff that were ensconced in a hotel on the flank of Capitol Hill on September 11th, the smoldering Pentagon a few miles away and the ubiquitous presence of uniformed personnel and military vehicles on the streets of Washington were a constant reminder that from this point forward, our sense of safety and security have been unalterably compromised.

Because Congress' priorities have changed dramatically over the last few weeks, bankruptcy reform, financial privacy, deposit insurance reform, and predatory lending – to name just a few topics – are no longer top-of-mind. Indeed, it is unlikely that these issues, which were advancing rapidly prior to September 11th as a result of the change in control of the Senate, will get serious attention any time soon – certainly not this year.

Instead, it is expected that Congress will turn its attention to money laundering (especially by suspected terrorists), federal reinsurance of disasters (natural and manmade), the solvency of the insurance industry (and monitoring whether any companies invoke “acts of war” escape clauses in contracts), and ensuring the proper functioning of the U.S. capital markets. It is worth noting that although the payments system and capital markets recovered with remarkable swiftness, banking committee leaders have suggested that an evaluation of contingency planning for these critical systems and markets should be undertaken to make sure they can respond as admirably to future assaults or disasters. In a related development, the American Bankers Association's Executive Vice President Don Ogilvie sent a letter to Treasury Secretary O'Neill urging the creation of a public-private sector task force on the security of the financial system, anticipating that actions to disrupt the financial system could be a future strategy of the terrorists.

Press reports indicating that some terrorists used debit cards to finance their activities could conceivably trigger some attention being paid to debit card marketing, issuance procedures and whether “know your customer” standards need to be developed with regard to such retail accounts. And, both houses of Congress are moving swiftly to authorize the Treasury Secretary to issue new savings bonds to support recovery efforts.

By operation of existing law (Soldiers' and Sailors' Civil Relief Act of 1940), the President's order authorizing the activation of 50,000 reservists potentially will impact all financial institutions. Under this law, lenders must reduce the interest charged on mortgages, credit cards, auto loans and other consumer debts, and some business loans, to a maximum of 6% for all covered borrowers. There are also significant restrictions on repossessions and foreclosures under this law.

The Major Issues.

Money Laundering. The one potential banking compliance issue that was developing momentum before September 11th, expanded money laundering legislation, has really picked up steam and is now at the top of the Congressional agenda. Attached is a spreadsheet prepared by the ABA which compares the pending proposals. Recent press reports suggest that a proposal yet to be introduced by Senator Leahy (D-VT), Chairman of the Senate Judiciary Committee, entitled the Uniting and Strengthening of America Act of 2001, is likely to be the vehicle for rapid Congressional action on money laundering. This measure, which is circulating in draft form, combines most of the elements of Senator Levin's (D-MI) S.1371 and significant portions of the administration's proposal and Senator Kerry's (D-MA) S.398. These provisions, among other things, would (i) prohibit financial institutions from establishing bank accounts with foreign persons without maintaining, for each account, a record of each individual or entity having a direct or beneficial interest in the account; (ii) prohibit U.S. banks and U.S. branches of foreign banks from providing banking services to foreign “shell banks” that do not have a physical presence in any country; (iii) require U.S. banks and U.S. branches of foreign banks that open a private bank account with \$1 million or more for a foreign person or a correspondent account for an offshore bank or foreign bank in a country

with a high money laundering risk to conduct “enhanced due diligence”; (iv) apply U.S. forfeiture rules to funds in a foreign bank’s U.S. correspondent account; (v) expand the definition of money laundering to include funds laundered through a foreign bank; (vi) extends U.S. courts’ long-arm jurisdiction over foreign persons committing money laundering offenses in the U.S. and authorized federal law enforcement to subpoena a foreign bank with a U.S. correspondent account for account records; (vii) grant Treasury authority to require additional record keeping and reporting of certain financial transactions if it is determined that a financial institution is involved with jurisdictions of “primary money laundering concern”; (viii) require the capturing of information concerning the “beneficial ownership” of any account opened or maintained in the U.S. by a foreign person or a representative of such person; (ix) require institutions opening payable-through accounts to identify each customer permitted to use the account and to obtain the same information on each customer that it would on persons residing in the U.S.; (x) require institutions that open or maintain correspondent accounts for a foreign financial institution or any financial institution operating outside of the United States to capture the same information as required of payable through accounts; and (xi) permit depository institutions to provide information to other depository institutions concerning possible involvement in potentially unlawful activity by an employee in a written employment reference.

Deposit Insurance Reform. This issue is now on the back burner. Having said that, new FDIC Chairman Don Powell, both in remarks to CBA’s Washington Visit audience on September 12th and more recently has indicated his support for comprehensive reform and for indexing of coverage going forward only. In addition, although he supports insurance premiums at some level for virtually all institutions, he is warming to the idea of providing credits to those that have paid into the fund in past years. He also supports assessing premiums on new entrants and the rapid growers (i.e., Merrill Lynch, etc.), although the extent of such assessment remains unknown. CBA has surveyed its membership twice on the coverage issue and finds there is strong support for increasing coverage to \$200,000 *provided* it does not result in a significant premium increase. Although the strongest proponents for such an increase are institutions under \$500 million in assets, California’s appetite for expanded coverage appears to be much greater than the industry as a whole nationally.

Predatory Lending. Congressional attention to predatory lending was heating up rapidly before the events of September 11th refocused the agenda. Now, attention to this issue is not expected before next year at the earliest. Meanwhile, the states (i.e., California and North Carolina again) and cities (e.g., Oakland and Sacramento) are pursuing their own predatory lending agendas and the federal appetite for preempting state and local laws is not strong. Attached is a spreadsheet prepared by ABA comparing the features of the bills currently pending in Congress to the existing provisions of the Truth in Lending Act. Most recently, House Financial Services Committee member Maxine Waters (D-CA) has introduced H.R. 2969, the Home Equity Loss Prevention and Economic Recovery Act, a bill to restore the tax deductibility of interest to all consumer loans, including credit cards, car loans and personal loans up \$10,000 per year and indexed to inflation. The objective of the bill is to reduce the demand for home equity loans, theoretically making consumers less vulnerable to predatory lenders offering tax deductible loan products.

Financial Privacy. Like other previously “hot” issues in Washington, financial privacy has been temporarily cooled by the events of September 11th. There are over 50 bills covering various aspects of privacy currently pending in Congress. Because of the pending battle over SB 773 (Speier) in California, people are beginning to question whether the “give GLBA time to work, just say ‘No’” mantra still has value. The optimum solution would be federal preemption of state laws in this area, but nobody believes this is achievable except at a considerable price. The likelihood that a bill moving beyond the boundaries of GLBA will pass next year in California will probably begin to change the dialogue at the federal level. Even if the states were merely preempted from changing the definitions and operational/transactional exceptions in GLBA, a “modified” preemption if you will, much of the damage from multiple overlapping state laws on financial privacy could be minimized. However, as we learned in California, coalitions are great for saying “no” but somewhat dysfunctional in making mid-course corrections or coming up with Plan B. For the time being at least, however, the privacy hawks will have their hands full in Congress

trying to deal with the privacy issues that will crop up in fighting the war on terrorism without looking unpatriotic.

Bankruptcy Reform. Although a conference committee on the pending bankruptcy reform bills was named several weeks ago, the rapidly sinking economy and the national security crisis have put this long-standing industry goal out of reach for some time. The vibrant economy that allowed bankruptcy reform to advance has been replaced by a situation in which many consumers will be losing their jobs in the next several months. Politically, it is not a good time to clamp down even though the policy arguments have not changed.

Real Estate Brokerage Powers for Banks. Although this is a regulatory issue, a campaign by the realtors to apply pressure on Congress to in turn apply pressure on the Fed to withdraw its pending proposal interpreting the "financial in nature" language of GLBA had been underway for several months. ABA, as of three weeks ago estimated that over 40,000 messages had been sent by bankers using ABA's click-on grassroots lobbying site. The volume of realtor mail was considerably greater. In fact, California's grassroots response was somewhat anemic notwithstanding authority for state banks to engage in these activities for years. Nonetheless, those who follow this issue expect the Fed to finalize its proposed rule as soon as Congress adjourns for the year, which could be as early as late October.